RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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July 1, 1981 **LETTER 812**

June 19, DJIA 996.19; PTI 1506; A-D Ratio –16.79
June 26, DJIA 992.87; PTI 1499; A-D Ratio –16.90

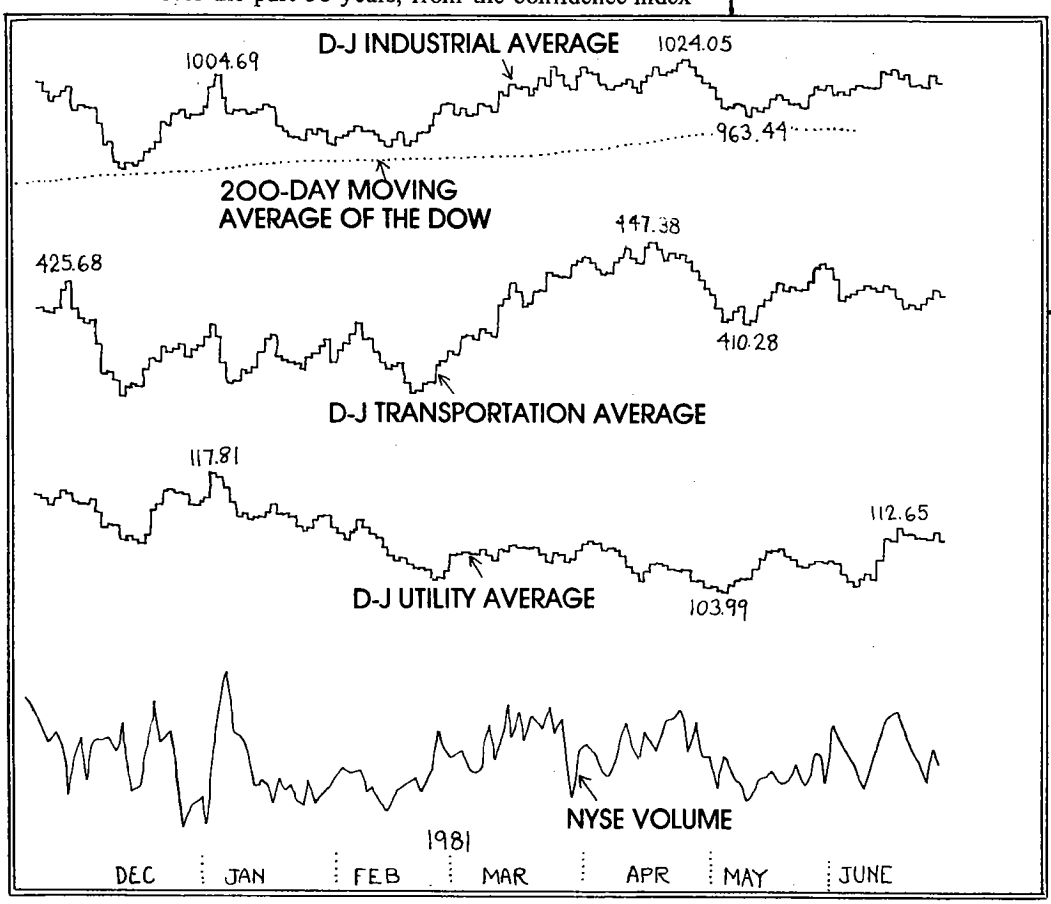
THE MARKET: You may be impatient, your broker may be "antsy," your financial adviser may be pulling his hair out, but the stock market makes its move in its own good time. Study the page 1 chart. The Averages recorded their highs of 1024.05 (Industrials) and 447.38 (Transports) in April. A rapid correction took Industrials down to 963.44, Transports to 410.28 – both lows recorded on May 11.

Since then the Averages have been traveling in that no-man's land between the primary highs and the last correction lows. When this kind of action occurs, no man knows for certain the direction of the primary trend. True, under Dow's Theory the trend is always taken to *remain* in the direction of the LAST primary confirmation. The last primary confirmation was bullish. Consequently, if the highs of 1024.05 and 447.38 are bettered, the primary bull market will be re-confirmed. But, if the Averages break below the May 11 lows of 963.44 and 410.28, a new primary bear market will be signaled.

What do you and I do? We get our own egos out of the picture and let Wall Street bring in the verdict. The verdict may come next week or six months from now. In the meantime, Dow 1000 has been crossed so many times that it's beginning to resemble the Maginot Lone after the German invasion.

I have a confession to make. I've followed literally dozens of market indicators over the past 30 years, from the confidence index to the A-D ratio, from the odd lots to the short interest, the specialists' shorts, the most-active stocks and what have you. As time goes on I'm giving less and less credence to these, and more credence to my own Primary Trend Index. It's not a matter of ego or professional pride. The reason I am placing more and more emphasis on the PTI is simply that – it works!

On June 24 the PTI did what it has done so many times this year, it climbed to a new high (at 1510). Note that the PTI is still holding above both its recent secondary rising trendline



FRONT PAGE COMMENT: The hard money seminar business is caving in, with many recent seminars either cancelled or running deep in the red (only Blanchard's New Orleans continues to look like a winner). The commodity business is now hurting, and I understand that many commodity letters are "on the edge" (which is only natural when commodities across the board are collapsing). Much the same can be said of the stock market area, where I have been receiving reports of tough times from a number of my friends (it's been a frustrating and difficult time in the stock market for over a year).

But the fact is that few advisers really think about that number one priority – how to make money for your clients the SAFEST and most INTELLIGENT way. As you know, I've been advising Treasury bills for quite some time. The bills may be boring, it's true, but those bills continue to represent the single safest and surest way to make money in a very difficult period.

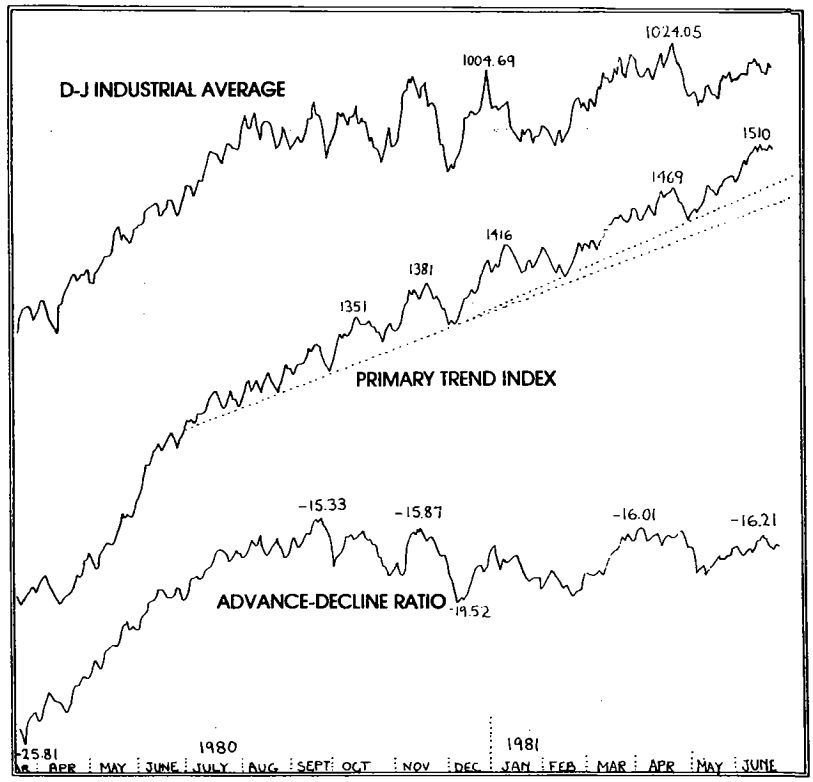
The rate of inflation is now coming DOWN. Yet illiquidity and massive new Government financing (which I've talked about endlessly) are keeping interest rates HIGH. The result is a gravy train for savers, and a very high rate of REAL RETURN for my subscribers. I estimate the true inflation rate currently to be down to about 8%. With T-bill yields at around 15%, we are receiving a bargain real return on our money of 7%. And we don't have to lay awake nights worrying about it!

I've done well in this business for 23 years by telling people the truth about investing, even when the truth wasn't particularly exciting or glamorous. I do it because I operate on one principle – I don't ask my subscribers to put their money anywhere that I wouldn't put my own.

and its longer rising trendline. As long as both of these trendlines (particularly the longer one) remain INTACT, the underlying technical structure of this market will remain bullish. As I've said dozens of times over the last year, no market collapse, no bear market is going to materialize as long as the PTI holds to a rising (bullish) trend. It just cannot happen.

The advance-decline ratio (bottom of the chart) presents a picture of "extended indecision." The A-D line recorded a 1980 high last September 19 (at minus 15.33) and a 1980 low on December 11 (at minus 19.52). The A-D has moved sideways between the boundaries ever since. The fact is that since June, 1980, the bullish and bearish forces in this market have been roughly in equilibrium, and the action of the A-D ratio simply reflects that situation.

All right, you retort, but then why hasn't the rising PTI forced the A-D and the major stock averages to higher levels? My only answer is that there is something very strange (and flawed) about this market, and the flaw can be seen by the fact that the rising PTI results merely in the market holding together rather than breaking out on the up side. All of which makes me think that when the PTI finally turns decisively down, we're going to see some very hard times. In the meantime we have to deal with what is, and I'm referring to a PTI that is still in a bullish trend.



INVESTMENT POSITION: The figure in the corner signifies that Dow's Theory is bullish, confirmed by a continuing bullish trend in the PTI. That means that you, as a subscriber, may hold a combination of no-load mutual funds plus 91-day Treasury bills. I can't give you the exact proportions of each to hold, but I can tell you that I have personally chosen to stay mainly in T-bills. I've done this because I find the safe, high T-bill rates well nigh irresistable. Furthermore, when I'm given my choice of a sure thing or a speculation, I always pick the sure thing (yes, I'm a financial sissy). Nevertheless, and despite my own position, you are entitled (as long as the little bull appears in this section) to opt for some equity.

LONG–TERM PERSPECTIVE: The page 3 chart takes my Primary Trend Index back to its inception in mid-1971. I think it's a chart of tremendous significance, and one that will bear a good deal of study.

As far as the PTI is concerned, there have been two tremendous sweeps since 1971. The first was the downward sweep (or crash) which took the PTI down 927 points from its early-1973 high of 1052 to its December, 1974 low of 125. Note that during 1971 through 1972 the Dow was in a definite rising trend while the PTI moved generally sideways. When the Dow rushed to 1051.70 high, the PTI failed by 20 points to better its 1973 high. The aftermath of that non-confirmation on the part of the PTI was the worst stock market smash since the 1930's.

The second great sweep was the rise in the PTI from its 1974 low to the present, and this rise was as complex as the 1973-74 smash was simple. I divide the rise from '74 to the present into *three parts*. The first rise took the PTI from 125 to its 1977 peak of 904. This period saw the Dow advance to the '76 high of 1014.79, then sag badly even as the PTI headed higher. When the PTI turned down in mid-1977 (from its 904 peak), that was a signal to "get out" as the entire market fell away with the Dow.

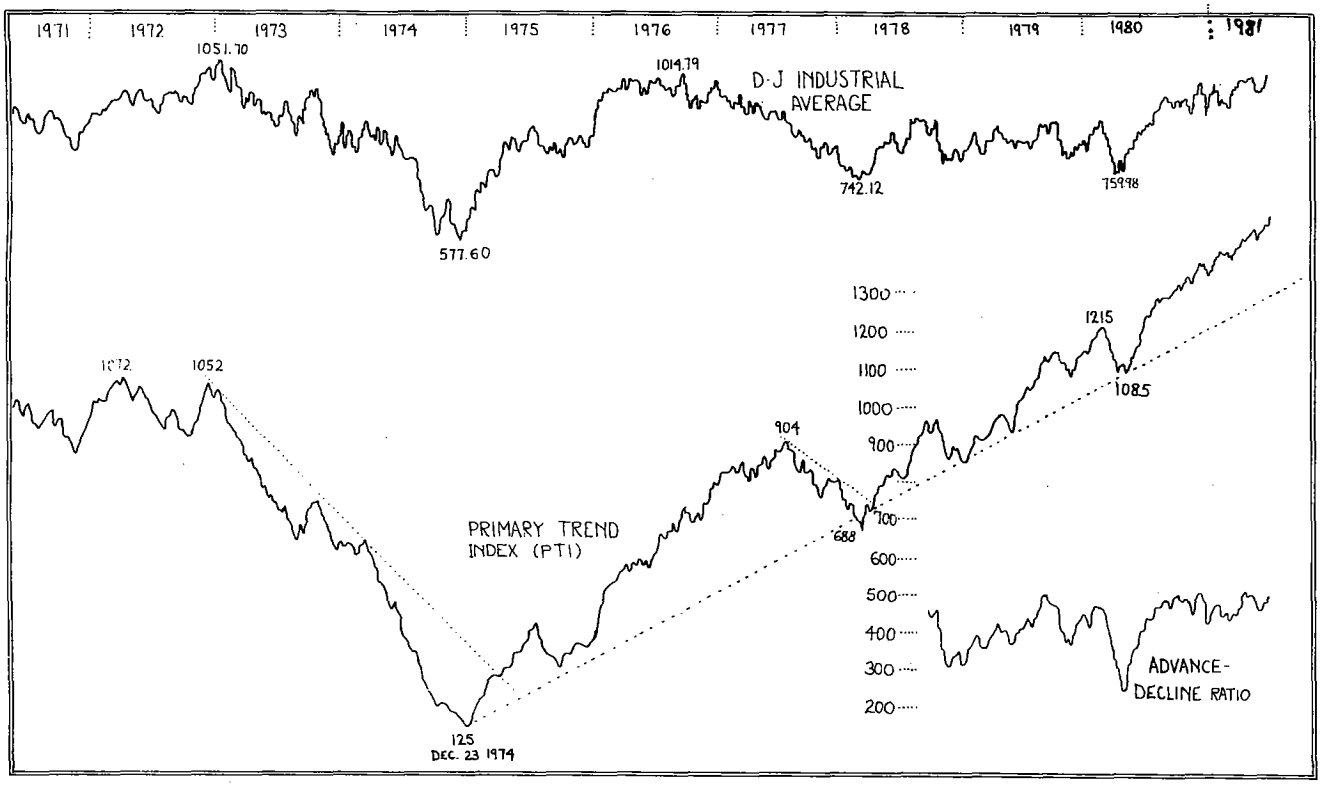
In February, 1978 the PTI hit a low of 688, which corresponded with the important Dow low of 742.12. From there the PTI headed higher, even though the Dow trended generally sideways. In early 1980, the market dropped sharply with the Dow halting at 759.98. But note that the corresponding low for the PTI was 1085, far above the early-1978 low. This implied that the technical strength of the market was far stronger than the poor performance that Dow suggested. And so ended the second segment of the rise from the 1974 low.

The third segment of the bull market began from the 759.98 Dow low and this third segment is still in force. The power of the PTI during this third segment is as striking as it is persistent. The fact is that since its 1085 low of April, 1980, the PTI has never looked back, nor has it suffered a reaction worthy of the name. The most amazing part of this third-segment advance is that the advance-decline ratio (see lower part of the chart) has done nothing since mid-1980. Throughout all this period of PTI strength, the A-D ratio has simply moved sideways. Furthermore, the broad stock indices such as the S&P 500 and the NYSE Index both recorded their highs on November 28, 1980 and have never been higher.

Question: Russell, the Dow has been unable to push substantially above 1000 since 1965. The A-D ratio on your chart has been moving generally sideways since 1978. Yet the PTI is setting all kinds of records. What is the meaning of this?

Answer: The PTI has been in a bull market for 6 years or ever since late-1974. This is a long time for any market trend, and frankly the length of the rising trend in the PTI worries me. I ask myself, "With six years behind it, how much longer can this bull trend last?" And I don't know the answer.

The main strength of the bull market in stocks lasted only two years after the 1974 bottom. Following 1976 the market became



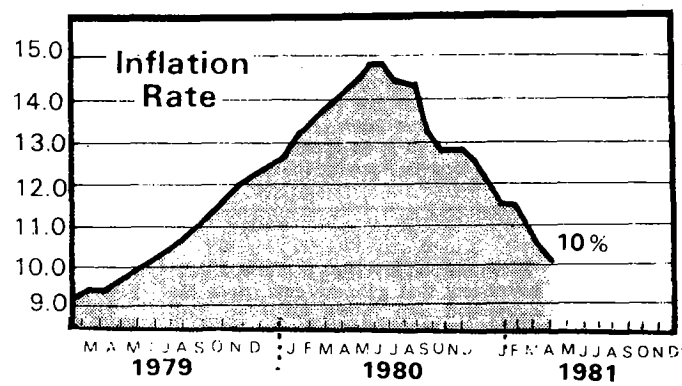
highly selective, with the focus of strength being concentrated in the Amex and over-the-counter areas. Note the A-D ratio at the bottom of the chart. From late-1978 to the present the A-D ratio has moved generally sideways – making little or no progress. The major composite stock averages topped out in November, 1980, and they have not since been higher. By the same token, the Dow made repeated attempts during 1978 to 1980 to push decisively above the 1000 level – only to fall back each time.

Question: What can we conclude from all this?

Answer: The rising PTI tells me that the back of the bull market is still INTACT. As long as the PTI continues to rise, I know that the technical structure of this market is positive – it is holding together. Even though the A-D ratio and the major averages have stalled out here, the rising PTI indicates that selected stocks are moving up. These selected issues are taking the place of other issues that are moving sideways or down.

But what worries me is the evidence that suggests that this bull market could be growing tired. If a steadily rising PTI now simply holds the market together, what happens when this 6-year trend in the PTI finally turns down? My guess is that at that time a major bear market will materialize. That bear market will serve to correct all the excess since 1974.

MONEY: Merrill Lynch must surely get the "1981 Hype and Chutzpa" Award for their full-page ad in the June 17 *WSJ* proclaiming in giant letters, "Bonds, the Dawn of a New Bull Market." When a new bull market starts, they usually don't ring the bells, but Merrill Lynch has the gaul to ring them anyway. In all my years in this business, I have never seen such hoop-la from the brokerage houses and institutions regarding "the new bull market in bonds." Considering the fact that most of the institutions are loaded with bonds, it's hardly surprising that they are dying for a bull market. There's just no shame on Wall Street.



This rate-of-inflation chart (courtesy of the excellent *Market Logic* service 3471 N. Fed. Highway, Ft. Lauderdale, FL 33306) shows what we've long suspected, inflation is winding down. In view of this, investors are flabbergasted because interest rates are remaining high. What's happening? (1) The Fed has been discredited on its "anti-inflation stand" on many occasions, and it's just possible that the Fed is tired of saying one thing and doing another. Thus, Fed funds are staying high – and Wall Street can hardly believe its eyes. (2) Illiquidity is also keeping interest rates high. There's a line a mile long waiting to sell bonds as soon as interest rates ease, and if business slows down there's going to be increasing pressure for cash (you pay your bills with cash, remember!).

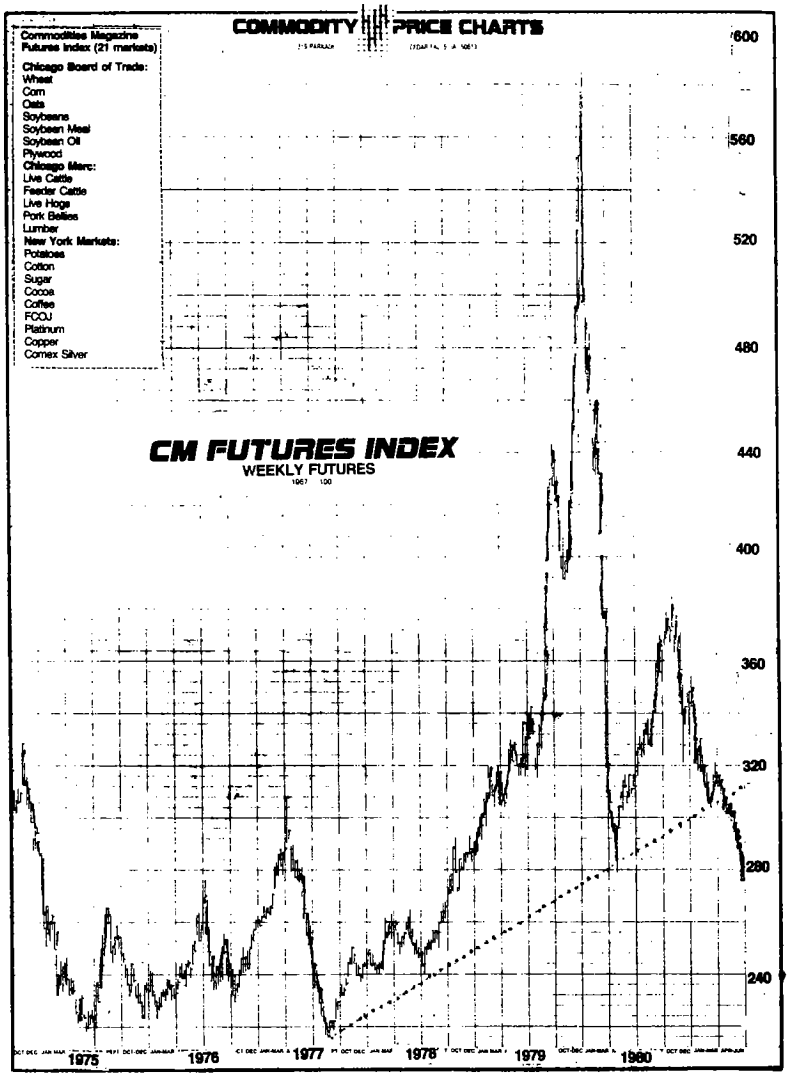
In the meantime, I include this little report on your government's debt. Note that we're only $34 billion away from the magic trillion dollar debt. Note also that interest on the debt through May is $59 billion (for 7 months). That project to $101 billion in service charges for carrying the debt or roughly $2 billion a week. Lower interest rates, anyone?

Government Finances

WASHINGTON (AP) – Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

Total public debt June 23	966,782
Interest on public debt May	7,819
Interest fiscal year thru May	59,206
Projected deficit fiscal 1981	54,894
Projected deficit fiscal 1982	44,961
Actual deficit fiscal 1980	58,990
Receipts fiscal year thru May	375,211
Receipts period last year	325,849
Outlays fiscal year thru May	439,647
Outlays period last year	381,454

CHART OF THE YEAR: The big story of 1980 was the bond market smash. The big story of 1981 is the crash in the commodity market. The accompanying chart traces *Commodity Magazine's* Commodity Futures Index from 1975 to the present. The Index is composed of 21 commodities but does not include gold. Here we see the great bull market in commodities topping out in January, 1980. We see the smash from 580 to 280, the rally back to 380 and then the June break below the rising trendline. The whole deflationary trend was confirmed last week when gold broke below 450.



Question: Russell, everybody's been waiting for the rate of inflation to come down. Now that commodities have caved in, gold has cracked wide along with silver and diamonds and precious metals, why isn't the stock market taking off, and why aren't interest rates collapsing? I thought a decline in the rate of inflation was bullish?

Answer: If this had happened in 1955 or even 1965 it would have been bullish. But now, with $4.8 trillion in debt hanging over this nation, declining inflation (perhaps leading to actual deflation) is ominous. Remember, the mountains of US debt has been handled, floated up, by inflation (more and more money printed to pay off the cost of the debts). But a move towards deflation means that dollars are worth more, that they are harder to come by. If this trend continues, the $4.8 trillion in debt is going to be almost impossible to service. And that's what the stock market is pondering as it moves sideways.

Question: What happens if this dis-inflation, as you call it, continues?

Answer: So far, nobody has really noticed what has been happening in commodities. If they do happen to notice, the comment is, "Oh, the traders are fooling around with the markets again." I disagree vehemently. I see this whole commodity cave-in as very ominous, and I think it will be reflected in the economy.

What happens if dis-inflation continues? People will get worried, and they will try to save. In the meantime, the debt gets harder and harder to service. This all leads to a state of extreme illiquidity in the economy – and then the panic for cash begins.

Question: Why a panic for cash?

Answer: Because everybody's in hock up to their eyeballs, and at today's high interest rates it takes a lot of money to remain solvent. Remember, for about two years now I've been saying that the US is so DEBT RIDDEN that it must INFLATE OR DIE. Well, the crashing commodity and gold markets are telling us that inflation could be over (at least for the time being). If that's the case, then the unbelievable debt levels of the US are going to loom as increasingly unmanageable.

Question: C'mon Russell, inflation has been in the saddle ever since World War II. Do you expect me to believe that this is the bitter end for inflation here in 1981?

Answer: Look, I'm no prophet, and I don't have a working crystal ball. My field is markets, and I believe what the markets tell me. So far, up to this point, the markets appear to be telling me that inflation is in deep trouble. Until the markets tell me differently, that's what I believe.

Question: OK, but won't the Fed start flooding the banking system with paper as soon as it feels that deflation is taking over?

Answer: I don't doubt that they'll try. But they may be late, and then again they may not try at all, I don't know. But I do know this. Today's money markets are supersensitive to Fed manipulations. Therefore, if the Fed opens the money spigots, the money markets will immediately protect themselves by crumbling. For every dollar that is "created" by the Fed via increasing reserves, there will be MORE dollars lost as the bond market protects itself by plunging to new lows. Look at the billions of dollars that have been lost in mortgages and bonds over the past few years as the Fed opened the spigots. It's a losing proposition for the Fed at this stage.

Question: Russell, what areas are you watching now?

Answer: The bond markets and the commodity markets have been smashed. The areas I'm watching now are the stock market and the housing market. If these two go, it will be a signal to me that the whole debt structure of the nation is starting to cave in. The fact is that the stock market is the last liquid market that has escaped unscathed. And the housing market is the last profitable market to remain (relatively) unscathed. The stock market is where the institutions have a good deal of their money and profits. And the housing market is where the public has most of its assets and profits.

Consider this: there is roughly $700 billion outstanding in mortgage debt. The value of all housing is estimated at $2.6 trillion. Over and above cost and mortgages, the American public has about $1 trillion in long-term profits in housing and real estate. This is the "big cushion."

This $1 trillion profit is the real "sitting duck" if deflation enters the picture. If even part of that $1 trillion profit is erased, the public is going to be devastated. Their nest egg will have cracked. That's a huge danger, and one that we'll be watching for. To my mind, the 1981 real estate market is comparable to the 1929 stock market – except that today's real estate market (and debt) dwarfs the stock market of 1929.

Question: So what so we do now, Russell?

Answer: Do what I've been telling you to do all along – don't buy anything you can't sell in an hour, and in general, stay LIQUID.

Question: Speaking of markets, Russell, how can your PTI continue to climb in the face of all this?

Answer: Look, I don't tell the PTI what to do, I simply follow it. I am apprehensive about what may happen when the PTI finally breaks its long rising trendline. Buy why search for new problems, I'll worry about that when it happens. As for explanations of why the PTI is doing what it's doing, ask me 6 months from now, and maybe I'll have one.

NOTES & QUOTES: Guess who is the biggest per capital spender for arms in the world today? Why it's Saudi Arabia. With an $88 billion budget, one-third of this amount will go to the purchase of arms in 1981. It's just not safe to own all that oil.

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World oil prices continue to sag. Britain recently cut her oil prices by $5. What does this mean? One thing it means is less revenue for Britain. For each dollar cut in oil, Britain loses $400 million in income.

* *

Which are the worst states for auto theft? Here are the latest figures (number of cars stolen per 100,000 cars) in terms of the worst states: Massachusetts is the winner with 1,144 cars stolen, second is Rhode Island with 793, California third with 738, Hawaii next with 715, then Nevada at 704, NY at 704, Conn. at 703, NJ at 696, Alaska at 616 and Mich. at 602. The lowest (best) states are N. Dakota at only 162, Mississippi with 167, S. Dakota at 174, Arkansas at 194, W. Va. at 202, Maine at 237, Virginia at 246, Idaho at 271.

* *

Russell Is Reading ..... additions to magazines I read; The *New Yorker* (read mostly by non-New Yorkers) is all facts, no feelings, and always stodgy and "safe." Good cartoons, excellent graphics, boring stories. *Financial World*, edited by my friend Alfred Kingon, top financial magazine with numerous excellent financial stories. *New York Times (Sunday) Magazine*, by far the best newspaper magazine in the nation. Their piece (June 14) on ex-CIA agents selling know-how and technical equipment and explosives to Libya made my blood boil. Books ..... I just finished a remarkable book, *Shopping Bag Ladies*, by Ann Rousseau (Pilgrim Press). Many extraordinary illustrations, the book is about those pathetic, crumpled old ladies that one sees (in every large city) as they sift through the trash, sleep in bus stops, sit dazedly on park benches – heart breaking. Just read *How to Survive and Grow Richer in the Tough Times Ahead*, by Tom Holt (Rawson, Wade), excellent and informative book by an old friend. Tom has few illusions about what lies ahead, and I can recommend this book to all my subscribers. Finally, a mis-titled book called *How You Can Use Inflation to Beat the IRS* by B. Ray Anderson (Harper & Row). This is a pip of a book covering all aspects of taxes and methods of minimizing taxes (much on inheritance taxes). This is one of the best and clearest books of its kind I have ever read. The author is both a lawyer and a certified tax specialist.

* *

Just for fun, New York's afternoon *Daily News* pitted four top stock market analysts against a few newspaper dart-throwers, gave each group $30,000 and eight weeks to make money in the market. So far, the dart-throwers are ahead in a very tough market. Two of the pros have increased the $30,000 while a 3rd pro is down to $24,000 and a 4th is down to an incredible $19,200.

* *

Living 20 miles north of Mexico, people in San Diego take more than a passing interest in what's happening south of the border. Listen to these statistics: in the last 25 years the population of Mexico has increased from 30 million to 68 million! Furthermore, 45% of the eligible Mexican work force have no regular jobs. One result is the huge movement of Mexican laborers across the border and into California, Texas, and other states.

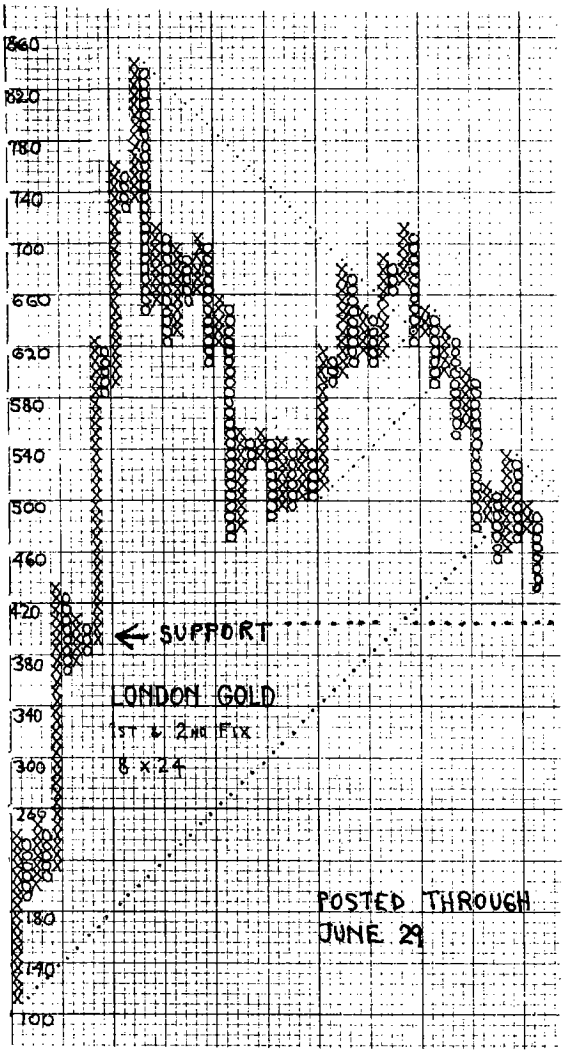
The current issue of *Life* has a major article on the problem. But it's not all bad. Listen to this quote from the *Life* article (and I agree, by the way, with what this man says):

> **"Why do we hire Mexicans? I have managed plants all over the country–in the East, manned principally by white ethnics; in the South by blacks; and here in California where the semiskilled work force is mainly Mexican. Now I would take one Mexican over any other five workers. They come to work on time, they respect authority, they have an aptitude for manual skills and they work very, very hard. They're still hungry–America hasn't spoiled them yet."**

A final comment about Mexico. Due to the slide in oil prices, Mexico has lost 25% of its oil export contracts in the last month! People ask me whether I think the oil glut is going to last. I tell them, "Look, it's only a matter of time before everybody in the US is driving a 4-cylinder car. And that's going to mean one heck of a lot LESS gas consumed – on a permanent basis."

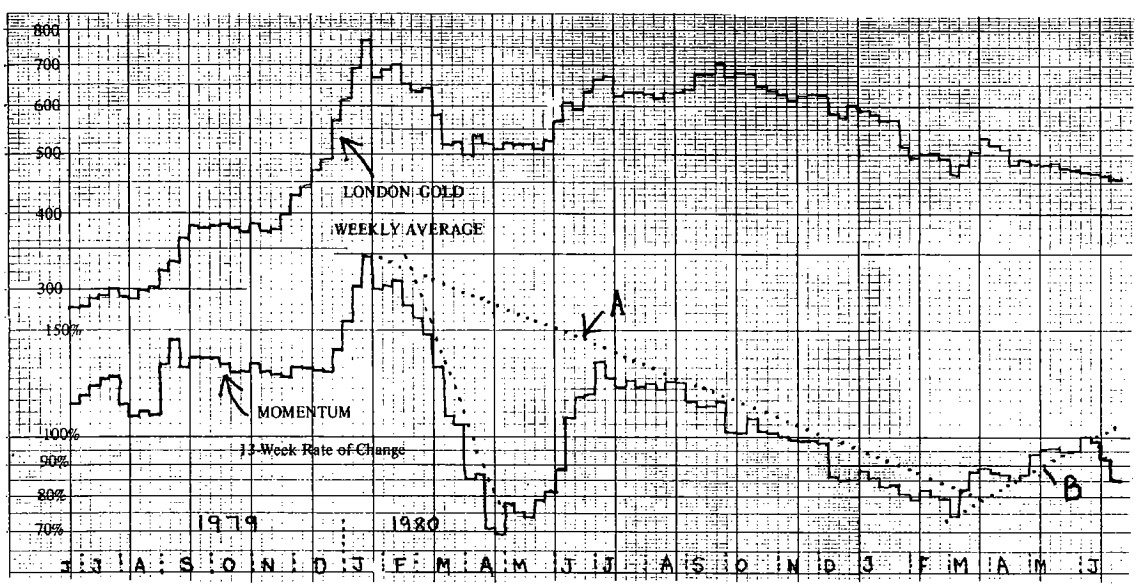
GOLD: As you can see on the page 6 point & figure chart, there is no support under gold now, gold having cracked the long trendline extending up from the August, 1976 low of 103.50. Normally, consolidation areas on the way up become support areas on the way down. So do the big even numbers such as 400, 450, 500, 600.

With the breaking of the 450 level last week, the next logical support area for gold is the 400-420 area which is identified by the arrow on the P&F chart. But the fact is (and most analysts hate to admit this) that NO MAN ALIVE knows where gold is going. Gold could stop at 425 and never go lower or gold could crack 400. Predictions from here on are simply ego-trips, and I warn against them. What I would like to do is IDENTIFY a gold bottom rather than predict one. So far, I don't see a bottom.



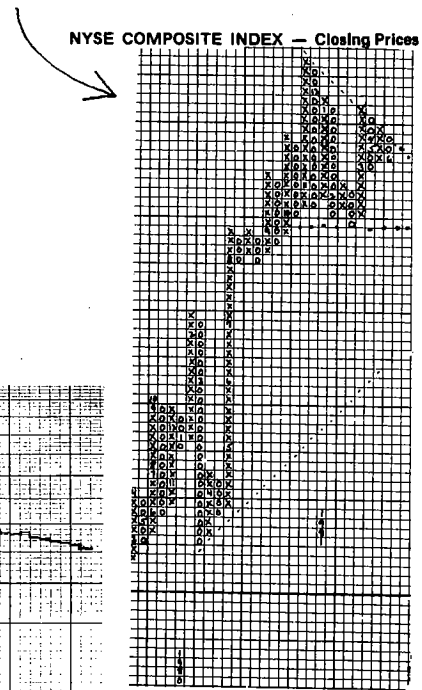
My moving average studies on gold (see last Letter) are still in a bearish mode with the 5-week MA at 463, the 13-week MA at 477 and the long-term or 50-week MA at 526. The 50-week MA is now declining at the rate of 3-4 points a week.

The lower chart is my 13-week rate-of-change (momentum) chart for gold. Note that the long decline in momentum was contained by trendline A on the chart. Then in March trendline B was formed, and momentum rose to just 100. But over the past two weeks momentum broke below trendline B again. As a rule, momentum will turn up BEFORE price, so we have more waiting to do prior to a good-looking gold picture on the momentum chart.



LATE NOTES: I keep three point & figure charts on the PTI. On my most sensitive chart (2 points and 6 points for a reversal) I got my first (very sensitive) signal of weakness in the PTI when it broke to 1499 on June 27 (the high was 1510 recorded on June 17). A further (more important) danger signal would be a drop to 1480, which would be below the steeper of the two PTI trendlines shown on the page 2 chart. Meanwhile, the D-J Transports are looking a bit toppy–so watch for confirming weakness in the Industrials. The "big" composite averages, the S&P 500 and the NYSE Index, have traced out a series of four descending peaks since November 28–but they are still moving generally sideways (they have not broken down). The market is playing the waiting game–so we wait!

The NYSE Index tracks the percentage movement for all NYSE issues and it is an indicator which I watch closely. Following the 1980 "spike" rise as seen on the chart, the NYSE Index has formed a massive consolidation pattern. Nearby indications for an attack on the November record high would be an Index close of 79. A nearby indication of lower prices and trouble would be an Index close of 75. Watching the NYSE Index is a simple way to monitor the overall trend of the entire market.



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